Service sector output decline gathers pace amid renewed drop in new business

Key findings

Solid contraction in activity amid weak client demand
Near-stagnation in employment
Inflationary pressures soften

Service sector firms in the US registered a sharper contraction in business activity at the start of the fourth quarter, according to the latest PMI™ data. The fall in output quickened amid a renewed decrease in new orders and weaker client demand. The impact of inflation and dollar strength also dampened foreign demand conditions further. Companies saw a solid fall in backlogs of work amid a reduction in new business, which in turn drove cost cutting efforts and the near-stagnation of employment at service providers. Weak demand conditions also weighed on business expectations which slumped to the lowest for over two years.

Amid reports of some input costs falling and in an effort to drive new orders, the rate of charge inflation eased to the slowest since December 2020.

The seasonally adjusted final S&P Global US Services PMI Business Activity Index registered 47.8 in October, down from 49.3 in September but higher than the earlier released ‘flash’ estimate of 46.6. The latest data signalled a modest contraction in business activity across the service sector. The decrease in output was commonly linked to lower new orders, with panellists attributing weak client demand to the impact of inflation and interest rates on increased client hesitancy and more frequent order postponements.

New business fell back into contraction during October, thereby signalling the third decline in new orders over the last five months. The drop in client demand was only marginal, but was often attributed to postponements or delays in order placement as customers were impacted by higher interest rates and inflation.

With regard to exports, service sector firms recorded a fifth successive decline in new business from abroad. The rate of contraction accelerated to the second-fastest since May 2020 amid weak global demand conditions.

In line with lower new orders and reduced business

Comment

Siân Jones, Senior Economist at S&P Global Market Intelligence, said:

"Service sector firms faced a challenging start to the final quarter of 2022, as a renewed contraction in new business dragged output down further. Demand conditions were hampered by tighter financial conditions and elevated rates of inflation, leading to reports of postponements and the delayed placement of orders as customers assess their spending.

"Subdued demand and weaker confidence in the outlook for output led to a near-stagnation in employment. Reports of the non-replacement of voluntary leavers brought signs that firms were evaluating costs and future demand more closely before advertising vacancies and expanding staffing levels.

"Nonetheless, momentum in previously soaring inflation slowed again. Hikes in costs softened, as service providers and manufacturers saw slower upticks in supplier and input prices. Meanwhile, private sector firms sought to boost demand through a slower increase in selling prices. Although softening, further elevated rises in prices paid by consumers present obstacles to firms in an already challenging demand environment and paint a concerning picture as we head towards the end of the year."

Data were collected 06-26 October 2022.
Source: S&P Global.
requirements, service providers indicated broadly unchanged employment levels at the start of the fourth quarter. A near-stagnation in workforce numbers brought to an end a 27-month sequence of expansion in staffing levels. Although some firms noted efforts to fill previously held vacancies, others stated that voluntary leavers were not replaced.

Despite little change in employment, lower new business inflows and sufficient capacity allowed firms to work through their backlogs during October. The level of outstanding business fell for the fourth time in five months, and at a solid pace.

Meanwhile, cost pressures softened slightly in October. The rate of input price inflation was faster than the series trend, but eased to the slowest since January 2021. Hikes in fuel, supplier and wage costs were linked to the further uptick in expenses, but reports of lower prices for some inputs were behind the slower rise.

In turn, and in an effort to drive new orders, service providers recorded a softer increase in output charges. Although firms continued to note the pass-through of higher costs to clients, some mentioned concessions made to customers. The pace of charge inflation eased for the sixth month running to the slowest since December 2020.

Business confidence across the service sector weakened in October. The outlook for output over the coming year was dampened by concerns regarding inflation and greater customer hesitancy. The degree of optimism remained below the series average and was the lowest since September 2020.

The S&P Global US Composite PMI Output Index* posted 48.2 in October, down from 49.5 in September. The fall in business activity was driven by a sharper decline in service sector output, but only modest overall as manufacturing output rose marginally.

Driving the decrease in activity was a renewed drop in new business during October. The fall in client demand was broad based, as manufacturers and service providers noted contractions. Dollar strength and inflation weighed on new export orders which fell further.

Rates of input cost and output charge inflation eased across the private sector in October. Reports of reductions in some material costs which were passed through to customers via concessions were cited as factors behind softer inflationary pressures.

Weak output expectations for the year ahead, alongside a solid fall in backlogs of work, led to a subdued increase in private sector employment. Although manufacturers saw a marginal uptick in workforce numbers, service providers kept staffing levels broadly unchanged.

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Survey methodology
The S&P Global US Services PMI™ is compiled by S&P Global from responses to questionnaires sent to a panel of around 400 service sector companies. The sectors covered include consumer (excluding retail), transport, information, communication, finance, insurance, real estate and business services. The panel is stratified by detailed sector and company workforce size, based on contributions to GDP. Data collection began in October 2009.

Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey variable. The index is the sum of the percentage of 'higher' responses and half the percentage of 'unchanged' responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted.

The headline figure is the Services Business Activity Index. This is a diffusion index calculated from a question that asks for changes in the volume of business activity compared to one month previously. The Services Business Activity Index is comparable to the Manufacturing Output Index. It may be referred to as the 'Services PMI' but is not comparable with the headline manufacturing PMI figure.

The Composite Output Index is a weighted average of the Manufacturing Output Index and the Services Business Activity Index. The weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The Composite Output Index may be referred to as the 'Composite PMI' but is not comparable with the headline manufacturing PMI figure.

Underlying survey data are not revised after publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series.

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